

Message Text

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TAGS: ECON, EFIN

SUBJ: VIEWS OF PRIME MINISTER'S ECONOMIC ADVISOR

REF: ROME 2014

SUMMARY: IN CONVERSATION WITH ECOMIN MARCH 5 NINO ANDREATTA, PROFESSOR ECONOMICS AT UNIVERSITY OF BOLOGNA AND ECONOMIC ADVISOR TO PRIME MINISTER MORO, AND ALLEGED AUTHOR OF ECONOMIC PLAN SUMMARIZED REFTEL, OFFERED HIS VIEWS ON A VARIETY OF CURRENT ECONOMIC ISSUES. IN ESSENCE, HE SEES SERIOUS ECONOMIC PROBLEMS BUT BELIEVES QTE CRISE UNQTE IS OVERDRAMATIZED, PARTICULARLY AS EVIDENCED BY SPECULATION AGAINST LIRA. ANDREATTA'S IMMEDIATE CONCERNS ARE EXCHANGE RATE AND UNIT LABOR COSTS. HE ALSO SEES DANGER OF OVERKILL IN PLICY OF MONETARY RESTRAINT, DOES NOT SHARE GENERAL CONCERN OVER CASH BUDGET DEFICIT AND BELIEVES THERE IS NO NEED AT PRESENT FOR INCREASED TAXES. END SUMMARY.

1. WHILE AGREEING WITH SERIOUSNESS OF ECONOMIC SITUATION, ANDREATTA BELIEVES THAT SITUATION HAS BEEN OVERDRAMATIZED, PARTICULARLY BY PRESS, WITH CHARACTERIZATION OF QTE CRISIS UNQTE. TWO ISSUES OF MOST IMMEDIATE CONCERN ARE EXCHANGE RATE AND UNIT LABOR COSTS. NOTING THAT HE HAD ADVISED ON JAN. 20 THAT BOI LET VALUE OF LIRE FALL 4-5 PERCENT AND THEN SEEK TO SUPPORT IT AT THAT LEVEL (WITH ASSISTANCE OF EC BORROWING, LIMITED OFFICIAL USE

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FED SWAP, ETC.), RATHER THAN WITHDRAWING FROM FOREIGN EXCHANGE

MARKET, ANDREATTA UNDERLINED EXTREME POLITICAL IMPORTANCE OF ENDING PRESENT STATE OF UNCERTAINTY. ALTHOUGH HE RECOGNIZES THIS IS VERY DIFFICULT IN ANSENCE OF MASSIVE FUNDS FOR SUPPORT OPERATIONS, THE SOONER IT CAN BE DONE THE BETTER. ACCORNDING TO ANDREATTA, THE LIRA IS PRESENTLY UNDERVALUED AND CONTINUING INSTABILITY IS RESULT OF SPECULATION AND PSYCHOLOGICAL FACTORS. ANDREATTA BELIEVES THAT IF ELECTIONS WERE HELD TODAY, ADVERSE EFFECT OF LIRA INSTABILITY ON CHRISTIAN DEMOCRATS WOULD BE SEVERE.

2. ANDREATTA CONSIDERS IT OF CRITICAL IMPORTANCE TO CONVINCE LABOR UNIONS THAT THEY CANNOT EXPECT SHARP WAGE INCREASES EVERY TIME CONTRACTS ARE RENEGOTIATED, BUT RATHER THAT THEIR DEMANDS MUST BE IN TUNE WITH ECONOMIC REALITIES. OTHERWISE, ONLY ALTERNATIVE WILL BE CONTINUING SERIES OF LIRA DEVALUATIONS. ANDREATTA BELIEVES THERE IS CONSIDERABLE ACCEPTANCE OF THIS AMONG TOP LABOR LEADERSHIP (AT LABOR CONFEDRATION LEVEL), BUT QUESTION REMAINS ABOUT DEGREE OF SUPPORT AT LOWER LEVELS.

3. ACCORDING TO ANDREATTA, IT IS GENERALLY ACCEPTED THAT ITALIAN ECONOMY IS BEGINNING TO MOVE OFF DEAD CENTER. CONCERN AMONG MANY OBSERVERS, HOWEVER, IS FOR 1977 RATHER THAN 1976. THIS CONCERN, WHICH HE RELATED IN PART TO PREDICTIONS OF CHASE ECONOMETRICS FOR 1978 (RPT 1978), IS THAT SERIOUS CRISIS IN BOTH BUSINESS CYCLE AND BALANCE OF PAYMENTS WILL HIT AT THAT TIME.

4. ANDREATTA EXPRESSED CONCERN THAT USE OF MONETARY RESTRAINT REPRESENTED OVERKILL IN TERMS OF SOLVING PROBLMS OF ITALIAN ECONOMY. HE ASSERTED THAT PAST EXPERIENCE SHOWS THAT TIGHT MONEY DOES NOT PRODUCE RESULTS UNTIL ABOUT 3-4 QUARTERS LATER. FURTHERMORE, HIGH INTEREST RATES CAUSE SHIFT OF SAVINGS INTO COMMERCIAL BANKS, AT LEAST INsofar AS SOPHISTICATED MONEY MANAGERS ARE INVOLVED, BECAUSE THEY PAY HIGHEST RATE OF INTEREST TO BIG DEPOSITORS. THIS RESULTS IN LACK OF MEDIUM AND LONG-TERM CREDIT AVAILABLE THOUGH SPECIAL CREDIT INSTITUTES AND SECURITIES MARKET IN MANNER SIMILAR TO DRYING UP OF FUNDS AVAILABLE FOR MORTGAGES IN US DURING US RECESSION.

5. HE ALSO EXPRESSED CONCERN ABOUT EFFECT OF TIGHT MONEY ON INVESTMENT. ACCORDING TO ANDREATTA, INVESTMENT IN 1975 WAS LIMITED OFFICIAL USE

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20 PERCENT LESS THAN IN 1974 (REAL TERMS) AND IT WILL DECLINE ANOTHER 10 PERCENT IN 1976 AND 5-6 PERCENT IN 1977. HE DID CONCED, HOWEVER, THAT LOW LEVEL OF INVESTMENT WAS ALSO IMPO- RTANTLY FUNCTION OF LACK OF CONFIDENCE AND LOW CAPACITY UTILIZATION, AND ADDED THAT INVESTORS WERE LIMITING ACTIVITIES TO USE OF LOANS FROM CREDIT INSTITUTIONS AT SUBSIDIZED RATES.

6. ANDREATTA SAW CASH BUDGET DEFICIT AS LESS SERIOUS A PROBLEM

THAN MANY OBSERVERS. HE POINTED OUT THAT EXPENDITURES WERE NOT OUT OF LINE IN RELATION TO THOSE IN OTHER WESTERN COUNTRIES (TAKEN ON PER CAPITA BASIS) AND HE FELT THAT QTE BALANCE UNQTE HAD BEEN ACHIEVED TO EXTENT THAT 1976 DEFICIT NOT EXPECTED TO EXCEED THAT OF 1975 (HENCE DECLINE IN DEFICIT IN REAL TERMS). HE ALSO SAW QTE BALANCE UNQTE IN FACT THAT WHEREAS CURRENT EXPENDITURES HAVE INCREASED, CAPITAL EXPENDITURES HAVE DECREASED, EVEN THOUGH THIS HAS ADVERSE LONG-TERM EFFECT ON ECONOMY.

7. WITH ECONOMY IN PRESENT DEPRESSED STATE, ANDREATTA DOES NOT SEE NEED FOR INCREASE IN TAXES. HE EXPRESSED GUARDED OPTIMISM OVER GOI'S EFFORTS TO IMPROVE TAX COLLECTIONS OVER NEXT YEAR OR TWO AND ASSERTED THAT GOI WOULD LIKE TO CHANGE VALUE ADDED TAX SYSTEM SO THAT COLLECTIONS ARE MADE BEFORE REACHING FINAL CONSUMPTION LEVEL (I.E. AT POINT OF SALE TO TO RETAILER AND POINT OF PURCHASE BY CONSUMER), AT WHICH WIDESPREAD EVASION TAKES PLACE. THIS, HE STATED, IS KEY TO CASH DEFICIT PROBLEM, I.E. HOW TO INCREASE REVENUE, NOT HOW TO REDUCE EXPENDITURES. VOLPE

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